

**Internal Revenue Service  
Appeals**

**Department of the Treasury**

Release Number: **201349023**

Release Date: **12/6/2013**

Date: **September 12, 2013**

**Address any reply to:**

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**Employer Identification Number:**

\*\*\*\*\*

**Person to Contact:**

\*\*\*\*\*

**Contact Telephone Number:**

\*\*\*\*\*

**Fax Number:**

\*\*\*\*\*

**UIL: 0501.03-30, 0501.33-00**

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**Certified Mail**

Dear

This is our final adverse determination with respect to your exempt status under section 501(a) of the Internal Revenue Code ("Code"). Recognition of your exemption under Code section 501(c)(3) is revoked effective June 1, 20XX.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the Clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

You are not operated exclusively for charitable, educational, or other exempt purposes. You did not engage primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). More than an insubstantial part of your activities were in furtherance of a non-exempt purpose and you were operated for the purpose of serving a private benefit rather than public interests.

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on form 1120 for any years, which are still open under the statute of limitations. Based on the information you furnished, it appears that returns should be filed beginning with the year ending May 31, 20XX. You should file any returns due for these years or later years with the Department of the Treasury, Internal Revenue Service Center, Ogden, UT 84201-0012 (as applicable for 1120). Processing of income tax returns will not be delayed because you have filed a petition for a declaratory judgment under Code section 7428.

If you have questions about this letter, you may write to or call the contact person whose name, telephone number, and IRS address are shown on the first page of this letter. If you write, please include your telephone number, the best time for us to call you if we need more information, and a copy of this letter to help us identify your account. Keep the original letter for your records. If you

prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person identified on the front of this letter can access your tax information and help you get answers. You also have the right to contact the office of the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance, or you can contact the nearest Taxpayer Advocate office by calling (954) 423-7677 or writing to Local Taxpayer Advocate, 7850 SW 6<sup>th</sup> Court, Room 265, Plantation, FL 33324. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Sincerely yours,

*Marsha A. Ramirez*

/s/

Acting Appeals Team Manager

CC: \*\*\*\*  
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DEPARTMENT OF THE TREASURY

October 5, 2007

Taxpayer Identification Number:  
EIN  
Form:

Legend

ORG= Name of organization

EIN= EIN of organization

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

ORG

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)  
Catalog Number 34809F

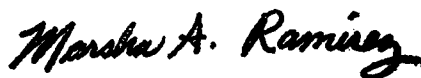
If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,



Marsha Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form **886-A**  
(Rev. January 1994)

## EXPLANATIONS OF ITEMS

Schedule number or exhibit

Name of taxpayer ORG.	Tax Identification Number EIN	Year/Period ended 5-x-200X & 5-x-200X
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### Legend

ORG = Name of organization

EIN= EIN of organization

NN = Name of individual

LOC = Location

ST = State

RR = Related organization

x = Amount

X= Year

WB = Website

EM = Email address

1. Whether ORG. (hereafter referred to ORG) is operated exclusively for exempt purposes described within the meaning of Internal Revenue Code section 501(c)(3)?
2. Whether ORG is engaged primarily in activities that accomplish an exempt purpose?
3. Whether more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose?
4. Whether ORG is operating to serve a substantial private interest rather than a public interest?
5. Whether any part of the net earnings of ORG inured to the benefit of private shareholders and individuals?

### **Facts**

### Background

ORG was incorporated May x, 200X in the ST. The articles of incorporation state that the corporation is organized exclusively for religious, charitable, scientific, literary, and education purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1986 or the corresponding provision of any future United States Internal Revenue Law.

The following individuals are listed as the initial board of directors:

NN

NN

NN

The address provided for the initial board of directors was:

LOC.

No officers were listed in the articles of incorporation.

### Form 1023 Application:

The organizations Form 1023 states their purpose is to promote social welfare and educate debtors, consumers and general public with respect to financial obligations and potential problems which may arise from use of credit card financing and other debt. Their primary activity shall consist of a debt assistance service which is designed to alleviate onerous interest rates and/or financing costs charged by some creditors to consumers. This activity will allow the organization to assist such consumers with their financial obligations. Educational information will be supplied so that the consumer may be apprised of how to avoid specific financial pitfalls. Their second activity shall consist of multimedia and seminar campaign designed to increase general public awareness of credit card debt. The activities were initiated on June x, 200X and conducted at the corporate offices, primarily by and through president, trained professionals, including attorneys, CPA's and experienced

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ORG

Tax Identification Number

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Year/Period ended

5-x-200X & 5-x-200X

client support personnel. The income shall generate from x% to x% of financial support from business organizations which deal with consumers who engage the filing organization's services. The remaining source of financial support shall consist of private contributions. The organization indicated it was an out growth of RR (RR) and more than x% of the board of directors serves as directors RR. See Exhibit 2-Form 1023

Correspondence between the Internal Revenue Service (IRS) and ORG:

Letter dated November x, 200X corresponding to a request of additional information during the application process.

- The board of directors were expanded to include three unrelated directors:

NN-President

NN-Director-Brother of President NN

NN-Employee of ORG

NN-

NN

- Seminars-the applicant is awaiting 501(c) determination before commencing operations. Hence, educational benefits, including seminars, have not begun. Seminars are planned to take place periodically, at least quarterly, with notice given to the general public, through websites. There will be no fee charge for the seminars and will be open to anyone who is interested. However, the educational information will be geared to the average American consumer, whether poor or middle class. The activity is the applicant's exempt purpose, i.e., consumer education.
- Debt assistance service-consumers request applicant's assistance through various means. Upon contacting the client it is determined if consolidation is a viable option based upon information submitted and clients' responses to "Counselors" inquiries. At that time a program is individualized for the client based on the creditors they are requesting assistance with. If the client is prepared to commit to timely and consistent payments toward the goal of becoming debt free, letters of proposal are sent to the creditors which include a monthly payment that is applicable based on the clients' balance, their history with that creditor and the corporate policy of the specific creditor regarding their participation in credit counseling programs. Once creditors respond verifying information and acceptance of terms, the program is put into place.

See **Exhibit 1** for copy of Form 1023 and **Exhibit 2** for correspondence 11-x-200X and 11-x-200X.

In a letter dated December x, 200X the Service recognized ORG as exempt from Federal income tax as an organization described in § 501(c)(3) of the Internal Revenue Code. An advance ruling was made on its private

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foundation status. The Service determined that ORG could reasonably be expected to meet the requirements of a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi).

Activity Description:

The primary activity engaged in by ORG during the years May x, 200X and May x, 200X is the enrollment of clients in debt management plans (DMP's).

1. DMP's specifically designed for each individual that calls the organization or visits the organizations website WB. If someone elects to join the program it will be considered a Debt Management Plan. Taking into consideration a myriad of components that together with counseling sessions and budget analysis, establish their DMP. Upon entering a DMP, clients are charged a set up/enrollment fee which ranges from \$x to \$x. A monthly service fee which ranges from \$x to \$x is assessed based on the number of creditors a client has, and are in place to cover overhead charges necessary to provide service to the client, including, the cost of telephone calls, postage, photocopies, facsimile charges, bank fees, data processing and account servicing. A \$x monthly ACH fee is charged to all accounts that have automatic debit of their payments. In addition to the fees assessed the client has to pay the necessary monthly payments that are required by the creditor.
2. Consumer Education is offered free of charge to all who wish to attend. For the year ended May x, 200X ORG had x participants receiving monthly financial education news letters free of charge and for May x, 200X there were x participants receiving monthly financial education news letters free of charge. For the years under examination there were no educational seminars. The only educational material disseminated was via e-mail or regular mail. ORG's e-mail address for newsletters is EM The regular e-mail address is EM Monthly newsletter topics consisted of:
  - **January-200X-Knee** deep in debt, Understanding vehicle financing, Credit card warnings, Home equity credit lines.
  - **February-200X-New** appliances and the extended warranty, Money saving reasons to get organized; Save money without really trying, Improve your personal finance.
  - **March-200X-Team** work needed, Groceries discoveries, Lunch club, Site seeing.
  - **April-200X-Save** a fortune, Hurry, smartest money moves to make Now, What's the best index fund? Make money by have a party.
  - **May-200X-Beat** high prices on popular services, Choosing a financial planner; the hottest jobs now and future, When is e-mail banking a good deal? Internet sales tax and junk mail checks—what's next?
  - **June-200X-Live** well for half as much, Beat the urge to splurge, Finding the money to build the rainy-day fund, Student loan up-date, The key—pay less using your computer.

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- **July-200X-Credit** counseling bonus; The willingness to pay factor; Know what you can afford.
- **August-200X-none**
- **September-200X-Start** with small savings, Bundle your insurance, Altering credit card spending.
- **October-200X-Credit** cards, yuppie food stamps, irrational financial decisions & behavior. When the red flag should be up.
- **November-200X-Credit** cards, Terms you should know, Annual fees.
- **December-200X-none.**
- January-200X-Loans/Interest Rates
- February-200X-Debt Collection Abuse
- **March-200X-The** Equal Credit Opportunity Act
- April-200X-Declaring & Filing Bankruptcy
- May-200X-Financial Planning

During the examination years, May x, 200X and May x, 200X, on the Form 990 returns, ORG has reported:

	5-x-200X	5-x-200X
<b>Income</b>		
Fair Share Contributions	x	x
Enrollment Contributions	x	x
Client Services Fees	x	x
<b>Total</b>	x	x
<b>Program Service Expenses</b>	x	x
Counseling Services-multimedia and seminars designed to increase general public's awareness of credit card debt	x	x
Client Services-debt assistance to debtors designed to alleviate onerous interest rates and/or financing costs charged to consumers	x	x
<b>Total Program Service Expenses</b>	x	x

Fair share revenues are generally recognized when funds are received from the client and subsequent disbursements are made to the client's creditors. Enrollment fee revenues are generally recognized when the client enrolls in the program, interviews with client have been conducted, payment is collected and negotiations on the client's behalf have commenced. Client service fees are recognized when the monthly payments are received from the client.

Credit counseling services are provided primarily by telephone. When a consumer completes an internet application the "Counselor" reviews the information and proceeds to call the consumer. The "Counselor" asks



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the consumer if they are looking for help with their debt. If the answer is yes then the "Counselor" proceeds with a specific pitch. The pitch is in relevant part, as follows:

Well here's what I'll do for you. I'm going to give you an explanation on the type of service we provide and we'll just take it from there. We are a 501(c)(3) non-profit debt management service, and the first thing we're going to do is give you the ease and convenience of one monthly payment. We're going to take all your accounts roll them into one payment for you and we take that payment and disburse it to your creditors monthly and it will be disbursed according to new guidelines. Now of course the new guidelines will be the lower interest rates we achieve for you..... What I would like to do for you is work you up a quote and with that I can show you a total monthly payment and length of time on our program as opposed to what it would currently take you. Do you have the names and balances of the creditors you owe? I do need to cover our fees for our services. The set up fee will be from \$x to \$x or statutory requirements. The Service fee will be from \$x to \$x per month or statutory requirements. Well the next step is up to you. If you would like to com aboard the program I would fax you our agreement and you send two pages back today. Those two pages, are the authorization page and ACH debit form. With those two pages back today you authorize me to draw up letters of proposal for each of the accounts in question, log you into the data base as a new client, and put your file under lock and key in my desk.

A welcome letter, creditor information form, service agreement, disbursement authorization form, ACH debits form for which a \$x administrative fee is added monthly to withdraw the funds per transaction, monthly household expense form, and a monthly budget form is faxed to the client to complete and return. Once the information is received then the process begins.

To be hired as a Credit Counselor at ORG, a person had to have a high school diploma or passed the General Education Development tests and previous credit counseling experience preferred. Their duties consisted of evaluating and contacting leads assigned by Credit Counseling Manager, review clients financial circumstances, evaluate appropriateness of DMP, explain terms of DMP, communicate with clients prior and subsequent to signing and returning the service agreements.

See **Exhibit 3** for scripts used by Counselors; **Exhibit 4** for Client welcome package; and **Exhibit 5** for Credit Counselor Job Description.

Generally, the client's first initial payment is used as the service fee for ORG and the remaining payments are for monthly fees and distribution to creditors. The payments to ORG from clients are made primarily by way of electronic funds transfer. ORG receive fairshare payments from creditors that participate in the DMP. ORG did not retain any records pertaining to telephone calls during the examination period. Electronic telephone records are only retained for a very short period of time. They do not record the conversations of the "Counselors".

During the examination, the EO Agent and Case Manager listened to a small number of telephone calls during the actual sessions. A number of the calls were "Counselors" returning the potential clients call in which they

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left messages. The typical message informed the potential client that they were returning their call and informed them they could lower the interest rates on their debt, assist them in managing their debt and help them get out of debt within a reasonable amount of time. On another call the "Counselor" discussed the client's debts/credit cards and cell phone bills. "Counselor" explained the organization is a § 501(c)(3) Debt Management Service organization and described the services-to lower interest rate and lower payments. "Counselor" explained the credit score and how it is determined and further discussed what cards to keep and what to put in the DMP. "Counselor" explained the debt management program and monthly fee of \$x, bank fee \$x, set up fee \$x, and payments to creditors are tax deductible. The client informed their monthly income is \$x and they will complete and e-mail the welcome packet. The call was then terminated." During the monitoring of the calls it was noted that the "Counselor" did not suggest or inquire about other means of paying off consumer debt such as taking out a loan, or home equity loan or selling assets. They did not discuss why they were having financial problems, how to prevent from getting in the situation again or creating a budget. They were only concerned about enrolling the clients in the DMP.

See **Exhibit 6** for Notes of Counselor's Calls.

ORG acquired the services of RR. (RR) a for-profit entity that was incorporated on July x, 200X by NN, the current president of ORG, NN-brother/vice president and NN-grandmother/treasurer. RR provided web links on behalf of ORG so customers could retrieve information on the debt management services. In 200X RR charged \$x per lead whereas RR charged \$x, RR charged \$c and RR charged \$c. In 200X RR charged \$x per lead whereas RR charged \$x, RR charged \$x. ORG paid RR \$x 200X and \$x in 200X to provide web links to customers. On January x, 200X NN an employee of ORG became the president of RR. On June x, 200X RR voluntarily dissolved.

See **Exhibit 7** for copies of corporate documents of RR; **Exhibit 8** for a description of the services rendered to ORG by RR; **Exhibit 9** for a copy of lead contracts; **Exhibit 10** for Brokers Productivity Reports.

Internal Revenue Service Valuation Engineer Report

The Valuation Engineer was asked to evaluate the fair market value of payments made by ORG for advertising services performed by RR and NN, President of ORG. The Valuation Engineer is an employee of the Internal Revenue Service Large & Mid-Size Business Division. The report covers an opinion of fair market value of services such as production and transmission of debt management leads to ORG by RR and NN for the tax years ending 5-x-200X and 5-x-200X. The Engineer is of the opinion that \$x paid for the production and transmission of debt management leads is the fair market value for each lead and the \$x paid to RR and NN for production and transmission of debt management leads is above fair market value.

See **Exhibit 11** for a copy of the Engineer's Report.

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**Law**

**Organized and Operated Exclusively for Exempt Purpose**

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations that are organized and operated exclusively for charitable, educational, and other specified purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1 (b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its "articles") as defined in subparagraph (2) of this paragraph:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

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Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Educational Purpose

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

- (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
- (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business. In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The Court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. The Court concluded, however, that the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was more indicative of a business than that of an educational organization. The Court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and that the organization was not entitled to be regarded as exempt.

Counseling As An Educational/Charitable Purpose

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Revenue Ruling 69-441, 1969-2 C.B. 115, granted section 501(c)(3) status to an organization with two functions: 1) educating the public about personal money management through films, speakers, and publications, and 2) providing individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, i.e., debt management plans, for some clients. The organization provided the debt management services without charge. It was supported by contributions primarily from creditors. By virtue of aiding low-income people without charge and providing education to the public, the organization qualified for section 501(c)(3)

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status. Moreover, by educating the public on budgeting information, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Id.

Revenue Ruling 65-299, 1965-2 C.B. 165, granted exemption to a section 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and help reduce the incidence of personal bankruptcy. Its primary activity was meeting with these persons to analyze their specific financial problems and counsel on payment of their debts. The organization advised applicants on pro-ration and debt payment, negotiated with creditors, and set up debt repayment plans. It did not restrict its services to the needy. The organization did not charge fees for counseling services; it made "a nominal charge" for monthly pro-rating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions. The Service maintained that the objective and activities of the agency contribute to the betterment of the community as a whole.

The District Court for the District of Columbia held in the following two cases that the credit counseling organizations under consideration were operating exclusively for exempt purposes.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. ¶ 9660 (D.D.C. 1978), the court held that an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service of ST is an umbrella organization made up of numerous credit counseling service agencies. These agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they did provide such services free of charge. As an adjunct to the counseling function, they offered a debt management plan. Approximately x percent of a professional Counselor's time was applied to the debt management plan as opposed to education. The agencies charged a nominal fee of up to \$x per month for the debt management plan. This fee was waived in instances when payment of the fee would work a financial hardship. The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from service fees.

The Court determined that the organizations were exempt under section 501(c)(3). The organizations fulfilled charitable and educational purposes by educating the public regarding the sound use of consumer credit without charge. These programs instructed the public on subjects useful to the individual and beneficial to the community. The counseling programs were also determined to be charitable and educational in nature. The Court concluded that the limited debt management services were an integral part of the agencies' counseling

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function, and thus charitable, but stated further that even if this were not the case, these activities were incidental to the agencies' principal functions.

Finally, the Court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3) or to provide its services solely without charge. Nonetheless, these agencies did not charge a fee for the programs that constituted their principal activities. They charged nominal fees for services that were incidental. Moreover, even this nominal fee was waived when payment would work a financial hardship.

Counseling in other contexts has been held to be a tax-exempt charitable activity. See Rev. Rul. 78-99, 1978-1 C.B. 152; Rev. Rul. 76-205, 1976-1 C.B. 154; Rev. Rul. 73-569, 1973-2 C.B. 179; and Rev. Rul. 68-71, 1968-1 C.B. 249. Overwhelmingly, the counseling activities described in these rulings were provided free of charge, and the organizations were supported by contributions from the public.

The Tax Court held that an organization that provided financial counseling and planning services to wealthy individuals who contributed to various religious organizations was not exempt from Federal income tax. *Christian Stewardship Assistance v. Commissioner*, 70 T.C. 1037 (1978). The court found that regardless of how the advice was characterized, the primary activity was to assist wealthy individuals in reducing their tax burden and that this activity served the private interests of individuals rather than a broad public interest.

Charitable Purpose (Charitable Class)

As noted above, the term "charitable" includes relief of the poor and distressed. Treas. Reg. § 1.501(c)(3)-1(d)(2). The Service determined that an organization that aided low-income individuals/families with financial problems and provided free counseling and a means for the orderly discharge of indebtedness, operated for the exempt purpose of relief of the poor and distressed. Rev. Rul. 69-441, 1969-2 C.B. 115.

In *Harding Hospital, Inc. v. United States*, 505 F.2d 1068 (6th Cir. 1974), the hospital asserted it provided medical services to persons unable to pay. Records revealed the hospital actually provided a very little free charitable service. The hospital's independent board of directors executed a contract with a partnership that gave certain physicians control not only over the patients' care but also over the income stream it generated. The contract also guaranteed the physicians thousands of dollars in payments for various activities. The court held that the hospital was not operated for charitable purposes but for substantial private benefit of the physicians.

Substantial Nonexempt Purpose

In *Scripture Press Foundation v. United States*, 285 F.2<sup>nd</sup> 800 (Ct. Cl. 1961), the Court of Claims found that the organization was directly involved in the conduct of a trade or business for profit, with religious objectives "incidental" to the business objective. The organization published and sold religious literature ostensibly in furtherance of the purpose of upgrading the quality of teaching materials for Bible instruction in Sunday

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schools. It generated what the court termed "very substantial" profits". 285 F.2d at 803. The court rejected the argument that profits alone preclude tax exemption but added, "If, however, defendant means only to suggest that it is at least some evidence indicative of a commercial character we are inclined to agree." *Id.*

The court also observed that "that there are many commercial concerns which sell Bibles, scrolls, and other religious and semi-religious literature which have not been granted exemption as to that part of their business." 285 F.2d at 806 fn 11. Consequently, the court found that the organization's activities are of a "nonexempt character."

In *BSW Group, Inc. v. Commissioner*, 70 T.C. 352 (1978), the Tax Court concluded that an organization that operated a consulting service for rural-related policy and program development was not tax exempt. The organization BSW provided its consulting services to tax-exempt clients charging fees such that BSW could retain a nominal administrative fee above the amount paid to consultants. The court focused on the organization's competition with commercial firms, its failure to receive or solicit voluntary contributions, and its failure to limit its clientele to section 501(c)(3) organizations. The Court stated, "Competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes." 70 T.C. at 358.

The Court of Claims held that Easter House, an organization that provided counseling service for fees to mothers placing children for adoption, did not qualify for exempt status because it had a primary business purpose, placing it in competition with commercial organizations providing similar services. *Easter House v. United States*, 12 Cl. Ct. 476, 486 (1987), *aff'd* without published opinion, 846 F.2d 78 (Fed.Cir. 1988), cert denied, 488 U.S. 907 (1988). Easter House counseled mothers further only if the mother had a financial need and was placing the adoption of her child through the organization. The organization's fee structure made it unreachable for a sizeable segment of the population. Usually, the fee the adoptive parents paid more than covered all services the organization it provided. The organization did not solicit or receive contributions. The Court of Claims stated that providing adoption services [with educational and charitable services to the unwed mothers and children] is not in and of itself an exempt purpose activity. *Id.*

The court in *Easter House, supra*, established the following factors characterizing a commercial operation:

- substantial profits,
- substantial capital surplus accumulation compared to direct expenditures for charitable and educational purposes,
- funding only from fees charged,
- no solicitation of funds from federal, state or local sources,
- run by paid staff only and no volunteer help.

The Court stated, "While these factors standing alone may or may not reflect the dominant commercial character of an organization, their totality . . . support [the conclusion that] . . . the operation is not distinguishable from a commercial adoption agency." 12 Cl. Ct. at 491.

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The District Court for the District of Columbia held that Arlie Foundation, an organization that carried out the exempt purposes for which it was formed (organizing, hosting, conducting, and sponsoring educational conferences at its facilities) was, nevertheless, not operated exclusively for exempt purposes. *Airlie Foundation v. Commissioner*, 283 F.Supp.2d 58 (D. D.C. 2003). The organization derived substantial income from activities such as weddings and special events, placing it in competition with other commercial and non-commercial entities. The Court stated that this "constitutes strong evidence . . . of a commercial nature and purpose." *Id.* at 65. Furthermore, though the organization contended most of its bookings were the result of word-of-mouth referrals, it maintained a commercial website and paid significant advertising and promotional expenses. *Id.* at 65.

Private Benefit

Treas. Reg. § 501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. *Id.*

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that the operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private rather than a public interest.

An organization must establish that it serves a public rather than a private interest and that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

The courts in the following cases have ruled an organization was not entitled to exemption under section 501(a) because it was operated for the benefit of private interests and more than an insubstantial part of its activities furthered a nonexempt purpose.

In *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), aff'd in unpublished opinion 647 F.2d 170 (9th Cir. 1981), several for-profit organizations exerted significant indirect control over *est of Hawaii*, an entity applying for exempt status, through contractual arrangements. The Tax Court concluded the for-profits were able to use the non-profit as an "instrument" to further their for-profit purposes. *Id.* Neither the fact that the for-profits lacked structural control over the organization nor the fact that amounts paid to the for-profit organizations under the contracts were reasonable affected the court's conclusion. Consequently, the Tax Court held that *est of Hawaii* did not qualify as an organization described in section 501(c)(3). *Id.*

Private benefits can include an "advantage; profit; fruit; privilege; gain; [or] interest." *Retired Teachers Legal Fund v. Commissioner*, 78 T.C. 280, 286 (1982).



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At issue in *Redlands Surgical Services v. Commissioner*, 113 T.C. 47 (1999), *affd*, 242 F.3d 904 (9th Cir. 2001) was whether the organization's activities should preclude its recognition as exempt from Federal income tax. The entity was a wholly-owned subsidiary of an exempt health care system and participated as general partner with a for-profit corporation.

Redlands Surgical Services argued that its activities furthered exempt purposes by promoting health and providing access to care for the community regardless of ability to pay. The Service contended that it was not operated exclusively for charitable purposes because it operated for the benefit of private parties; it failed to benefit a broad cross-section of the community. The court held the organization ceded effective control to for-profit parties, conferring significant private benefits on them. Therefore, it was not operated exclusively for charitable purposes within the meaning of section 501(c)(3). *Id.*

In *The Nationalist Movement v. Commissioner*, 37 F.3d 216 (5<sup>th</sup> Cir. 1994), the court held that the counseling services provided by the organization and legal activities performed were not exclusively charitable in nature. Since the organization's social and legal services comprised approximately 45% of its activities and were not primarily for the benefit of the public, the Fifth Circuit held that "the Tax Court properly found as a matter of law that the [organization's] non-exempt activities were more than insubstantial." 37 F.3d at 221.

The Tax Court stated in *American Campaign Academy v. Commissioner*, 92 T.C. 1053, 1068 (1989), that they "have consistently recognized that while private benefit and inurement prohibitions share common and often overlapping elements, the two are distinct requirements which must independently be satisfied." (citations omitted). The presence of private inurement (to an interested person or insider as to the organization) violates both prohibitions, but the OBDece of inurement does not mean the OBDece of private benefit. *Id.*

The Tax Court upheld the denial of exempt status to American Campaign Academy, a school that trained individuals to fill positions in political campaigns, because it found that the organization's activities benefited the private interests of certain entities and individuals who were not insiders as to the organization. While the Service contended the entity did not operate exclusively for an exempt purpose because it engaged in activities that served private interests rather than a public purpose, the organization argued that the political party and candidates could not be construed as *insiders* of its organization. The court held that prohibited private interests include those of third parties and that if more than an insubstantial part of the organization's activities further such private interests, the organization is not operating exclusively for an exempt purposes with the meaning of section 501(c)(3). *Id.* at 1079.

### Government's Position

#### Not Operated Exclusively for an Exempt Purpose

The Government's position is that ORG does not operate exclusively for an exempt purpose as required by IRC § 501(c)(3) and therefore should no longer be exempt from Federal income tax. ORG's main activity is to operate a debt management program by offering debtors a way to consolidate creditor payments at a lower

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interest rate. It collects and disburses the payments for a monthly administrative fee. Like the organization in *Better Business Bureau, supra*, ORG's activities serve a commercial purpose.

It operates substantially for the benefit of private interests, contrary to Treas. Reg. § 1.501(c)(3)-1(c)(1). ORG has not established it serves a public rather than private interest as required by Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii).

#### Not Operated Exclusively for an Educational Purpose

ORG is not operated exclusively for charitable purposes described in IRC § 501(c)(3), which includes education. While ORG's activities include some amount of public education and individual training, they are not exclusively educational. ORG's DMP activities constitute almost all of its activities.

Like the organization in *American Institute for Economic Research v. United States, supra*, ORG has a substantial non-exempt commercial purpose. By any measurement, its primary activity is the operation of its DMP.

ORG's educational activities do not resemble the exempt educational organizations described in Revenue Rulings 69-441, 65-299 or in the case of *Consumer Credit Counseling Services of Alabama, Inc. vs. U.S., supra*. Unlike the organizations described in Revenue Rulings 69-441 and 65-299, the majority of ORG's communication activity does not include educating individuals or families on budgeting, buying practices, or the sound use of consumer credit.

Unlike the individuals and families in Revenue Rulings 69-441 and 65-299 as well as those in *Consumer Credit Counseling Services of Alabama, supra*, ORG's clients made more than a nominal payment for ORG's services (DMP payment processing).

ORG received significant fair share income (not contributions) from credit card companies (See Rev. Ruls. 69-441 and 65-299). It did not receive voluntary contributions from community businesses, labor unions, government and private foundation grants, or United Way (See Rev. Rul. 65-299 and *Consumer Credit Counseling Services of Alabama, supra*.)

ORG did not negotiate with clients' creditors on their behalf. Each creditor maintains their own predetermined fair share percentage based on client acceptance. ORG does not have agreements with creditors; fair share determination and distributions are at the discretion of each individual creditor.

ORG's Board of Directors was not from the community at large. The Board mainly consisted of relatives of the president and employees of ORG.

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ORG hires the RR to train and certify the "Counselors" on a bi-annual basis or as needed. The training is done over a three day period and in house training is for one month.

The public is made aware of ORG mainly through the internet or referrals from existing or past clients. If a potential client is interested in obtaining more information about ORG, they can complete a free, no obligation assessment of their financial well being. If a potential client decides to participate in the program they may call ORG to join the DMP.

The content of the telephone conversations between ORG "Counselors" and potential clients did not appear to be educational. The telephone calls were generally less than x minutes. In that amount of time it would be difficult to obtain all the financial information required for DMP enrollment and provide financial education to the caller. ORG "Counselors" needed to keep the calls time low in order to handle the volume of callers.

To determine the content of the telephone calls between ORG's "Counselors" and potential clients, IRS agent and manager listened to a small number of live telephone calls during the actual sessions. ORG did not make recordings of their telephone calls. The educational content of almost all the calls were negligible. A number of the calls were "Counselors" returning the potential clients call in which they left messages or enrolling an individual in the DMP. The typical message informed the potential client that they were returning their call and informed them they could lower the interest rates on their debt, assist them in managing their debt and help them out of debt within a reasonable amount of time. Another call the "Counselor" discussed the clients' debts/credit cards and cell phone bills, described the services to lower interest rate and lower payments. During the monitoring of the calls it was noted that the "Counselor's" did not suggest or inquire about other means of paying off consumer debt, or why they were having financial problems, how to prevent from getting in the situation again or creating a budget. They were only concerned about enrolling the clients in the DMP.

During the years of the examination there were no educational seminars. The only educational material disseminated was via their e-mail or regular mail after a client has enrolled in the DMP. ORG e-mail address for newsletters is EM. The material has some educational content, however, the effectiveness is dependent upon a client's motivation to read and study them. It appears the educational information informed the clients on how to control their finances through debt management and debt consolidation programs.

No Charitable Purpose (Charitable Class)

ORG does not target a particular charitable class. For example, unlike the organization in Revenue Ruling 69-441, ORG does not restrict its activities to low income individuals and families and charges fees for services rendered. Counseling is provided only to clients that enroll into a DMP. ORG offers its services only to DMP enrollees. The program is offered to all who either call or visit ORG website.

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A review of the client profiles indicated there was no set guideline for monthly income or number of creditors to participate in the DMP. Specific guidelines are set by the participating credit card companies. Some clients had records showing no monthly net income up to \$x of monthly income. ORG did reduce some of the fees; however, none of the fees were waived.

Business Purpose

In Revenue Ruling 69-441, the organization established budget plans. In *Consumer Credit Counseling Services of Alabama, Inc. v. U.S.*, *supra*, the organization administered a debt management program, but the DMP activities were very small compared to their educational activities.

In *Consumer Credit Counseling Services of Alabama, Inc. v. U.S.*, *supra*, only x percent of the "Counselor's" time was applied to debt management plans, and the charge for the service was nominal. ORG differs from this organization in that its DMP program constitutes the majority of its activities. Also, it adds a fee for service (\$x to \$x) to each client's monthly statement, which is a significant percentage of its annual revenue. ORG's large number of DMP clients (an average of x) is one indication that its activities are primarily related to debt management and creditor intercession.

Like the organization in *Scripture Press Foundation*, *supra*, ORG's minimal educational activities are incidental to its DMP activities. ORG's operation of a DMP in and of itself does not qualify as conducting an exempt purpose activity. This non-exempt purpose activity is substantial in nature, thereby destroying the organization's tax exempt status. ORG's emphasis on its very large DMP is an example of its underlying commercial motive. As in *Better Business Bureau of Washington D.C.*, *supra*, ORG has a "commercial hue and its activities are largely animated by this commercial purpose."

In effect, since the credit that clients placed into the DMP is mainly credit cards, ORG worked to collect on monies on behalf of the credit card companies via the DMP. This placed ORG in direct competition with for-profit collection agencies, which creditors use to collect certain accounts.

The DMP's prominence is further demonstrated by the content of voluminous calls between ORG workers and clients wherein most of the conversation was DMP-oriented.

Operated for Substantial Private Benefit

The Government's Position is that ORG is not operated exclusively for charitable purposes such as those described in IRC § 501(c)(3) because it operates for a substantial private, not public, benefit.

ORG's *primary* activity is its debt-management program, which is not a charitable activity described in IRC § 501(c)(3) as discussed above. ORG is not furthering any charitable purposes when it mass markets its DMP and processes payments to creditors. Operation of the DMP benefits the private interests of ORG, its president,

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employees and RR. Their private benefit far outweighs any public interest. Therefore, ORG serves a substantial private interests and its net income inured to an insider.

Private Benefit

Section 501(c)(3) does not prohibit dealings between a charitable organization and its insiders as long as those dealings are at arm's length, in good faith, and reasonable. For example, if an organization pays a reasonable compensation to its founder for services rendered, that is not inurement. However, when the interests of the charity are sacrificed to the private interests of those in control, exemption is precluded because the organization is serving private interests.

In *est of Hawaii v. Commissioner, supra at [cite page]*, the court stated the organization depended on its tax exempt status for its business relationship with several for-profit corporations, "an element that indicates the possibility, if not likelihood, that the for-profit corporations were trading on such status." This is analogous to the relationship between ORG and RR.

ORG's section 501(c)(3) status was crucial to RR marketing activities. Without it, RR could not have conducted its marketing. It appears that the main reason ORG was organized as an exempt organization was to avoid the regulatory provisions of the Credit Repair Organizations Act (CROA), 15 U.S.C. section 1679, et sec, CROA was enacted to protect consumers by banning certain deceptive practices in the credit counseling industry, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. If ORG were a for-profit company, federal law would prohibit it from purchasing leads from RR and procuring a service to make cold calls to potential customers. Because § 501(c)(3) organizations are exempted from CROA, ORG and RR are able to engage in deceptive business practices that Congress intended to prohibit when it passed the CROA law.

This demonstrates that ORG is operated for a substantial non-exempt purpose, which is carrying on a business while avoiding federal regulation.

Furthermore, ORG could not collect "fair share" payments from creditors if it did not have exempt status. The entire DMP business depended on an organization having tax-exempt status.

The providing of a program for consolidation of debt payments with lower interest rates for clients and a convenient debt collection service for creditors is not an exempt activity in and of itself. The debt management program provided by ORG was not incidental to a primary educational program. Rather the educational activities appeared to be incidental to its primary activity which is the selling of DMP to the public.

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**Taxpayer's Position**

The Taxpayer has not provided the agent with their position at this time.

**Conclusion**

ORG was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose, more than an insubstantial part of its activities are in furtherance of a non-exempt purpose, and it operated for the purpose of serving a private benefit rather than public interests. Accordingly, it is determined that ORG is not an organization described in § 501(c)(3) and is not exempt from income tax under § 501, effective June x, 200X.